

Federal Proposed Rulemaking

- Lessees no longer allowed to use FERC tariffs in lieu of actual transportation costs
- If Differential from NYMEX does not reflect actual costs, company can apply for permission to use actual costs if demonstrable

Federal Proposed Rulemaking

Valuation of RIK oil

- Value will be tied to non-arm's-length benchmarks
 - **NYMEX outside West Coast**
 - **ANS in California and Alaska**
- Location differentials will be specified in RIK contract
- Allows certainty in billings to small RIK refiners

Federal Proposed Rulemaking

- Next Steps
 - Proposed rule published
January 24, 1997
 - Comment period scheduled to end
April 28, 1997
 - Public hearing scheduled for April 15 in
Denver and April 17 in Houston

Indian Proposed Rulemaking

- Consulted with Indian representatives
- Completed Economic Impact Analysis (DM512)
- Hope to publish proposed rule by
April 25, 1997

Indian Proposed Rulemaking

Value would be the higher of:

- Avg. of top 25% of daily NYMEX settle prices in given month (Differentials allowed from reservation to index pricing point), or
- Gross proceeds of the lessee or its affiliate, or
- Major portion value based on a 75% median value of gross proceeds in the field or area.

Federal Proposed Rulemaking

Differentials from NYMEX in Cushing, OK

- Platt's differentials from Cushing to Market Centers; e.g., St. James, Midland
- Actual company rate from market centers to aggregations pts., or MMS published rate based on info collected on exchange agreement differentials
- Actual costs from aggregation points to lease

Federal Proposed Rulemaking

- New Benchmark for California and Alaska:

Alaska North Slope spot price less differential to the lease

Federal Proposed Rulemaking

New Benchmarks (Outside West Coast)

- For sales to affiliated refiners, value will be based on average of daily NYMEX settled prices for West Texas Intermediate (WTI) crude less differential to the lease
 - » Delivered at Cushing, Oklahoma
 - » Benchmark Crude in the U.S.
 - » Paper Transfers for almost all transactions
 - » Trade month tied to production month

Federal Proposed Rulemaking

- True outright arm's-length sales will continue to be valued based on gross proceeds
 - Intent is to allow independent producers to continue to value production based on the price received under an arm's-length contract
- Non-arm's-length sales, exchange agreements, other reciprocal purchases, and arm's-length sales that do not reflect total consideration will be valued based on new benchmarks

New Proposed Rulemaking

- MMS/STRAC/WSLC team formed to develop proposed rulemaking
- Team met with several crude oil consultants including
 - Micronomics
 - Summit Resources
 - Innovation and Information Consultants
 - Crude oil producers/marketers
- Separate Federal and Indian Rules

New Proposed Rulemaking

- Advanced Notice of Proposed Rulemaking published on December 20, 1995
- Summary of comments:
 - Industry wants delay pending other litigation
 - States/others say postings don't reflect market value; indices better; recommend publishing interim rule

Federal Proposed Rulemaking

New Benchmarks (Outside West Coast)

For sales to non-refiner affiliates, value will be based on the affiliate's arm's-length resale

- Option to base value on average of daily NYMEX settled prices for WTI crude less differential to the lease

Why the Need for New Regulations

Problems gaining access to affiliate records

- Most crude oil disposed of under exchange agreements
- Overall balance maintained by major producers

Current Regulations - California

- In Calif., MMS pursuing underpaid royalty from top 20 producers for January 1, 1980, to present.
 - These producers account for nearly 97% of Federal production in California for this time period.
- MMS has already issued bills to integrated producers for Jan-1980 through Feb-1988.

Current Regulations - California

- Bills for post-1988 period will be issued as soon as records obtained
- MMS using subpoenas to get records, if necessary
- Lawsuits have been filed by Mobil and others

Current Regulations - Nationwide

- MMS actively pursuing oil valuation issues in other States and the OCS.
- Auditors holding open most recent audit period.

Why the Need for New Regulations

Long-standing allegations in Calif.--majors post prices below market value

- Private royalty litigation regarding crude oil valuation
- Post prices no longer represent market value
 - Form a basis for negotiations
 - Do not include premia

Current Regulations

Buy/Sell Agreements

- Exchange of oil at one location for oil at another location.
- Price/differential may not represent total consideration for the value of the oil.
- Value includes any premiums received for the resale at the subsequent exchange point.

Current Regulations

Benchmarks

- First--Lessee's posted/contract prices
- Second--Others' posted prices
- Third--Others' arm's-length contract prices
- Fourth--Arm's-length spot sales or other relevant matters
- Fifth--Net-back or any other reasonable method

Current Regulations

Non-arm's-length contracts

Higher of:

- First applicable benchmark or
- Gross proceeds accruing to the lessee
 - Premia received by the affiliate are part of gross proceeds accruing to the lessee

Current Regulations

- Gross proceeds accruing to lessee under an arm's-length contract represents value
 - Arrived at in the market place between independent, nonaffiliated parties
 - Opposing economic interests
- Premiums are a part of gross proceeds
- Gross proceeds may not be reduced by marketing costs or costs to place production in marketable condition

As Bob noted, we have two public hearings scheduled, one in Denver on April 15 and one in Houston on April 17. We're expecting the largest turnout in Houston.

Ms. Debbie Gibbs-Tschudy, Chief, Royalty Valuation Division in Denver is with us today to provide an overview of the proposed rule.

Thank you, Senator Breaux.



PROPOSED CRUDE OIL VALUATION REGULATIONS

**Congressional and Industry Briefings
April 9, 1997**

Crude Oil Valuation

- Current Regulations
- Why the Need for New Regulations
- Proposed Federal Rule
- Proposed Indian Rule

Current Regulations

- March 1, 1988 Regulations
- June 24, 1996 Valuation Guidance for Auditing Crude Oil Premiums

**Opening Statement for Cynthia Quarterman for
April 9, 1997, Meeting with Senator Breaux**

Good Morning everyone. Thank you for coming.

I would like to thank Senator Breaux from Louisiana for providing this forum on our proposed Federal oil valuation rule.

As Bob noted, revising our current Federal oil valuation rules began with the publication of an Advanced Notice of Proposed Rulemaking on December 20, 1995. The current MMS Federal oil valuation rules rely fairly heavily on posted prices, especially in non-arm's length situations. However, many believe postings now substantially understate market value.

The Advanced Notice of Proposed Rulemaking asked for comment on whether postings still represent market value and suggestions on alternative valuation bases. The comment period ended in March 1996.

Industry commenters generally recommended a delay in any further rulemaking pending the outcome of private litigation on this issue. State and Indian commenters told us that posted prices do not represent market value and that market indices such as spot price or NYMEX are better indicators of market value for crude oil.

The team we formed to develop a proposed rule included representatives from MMS, STRAC, the Navajo Nation, and the Western States Land Commissioners. The team consulted with crude oil marketers, major and independent oil producers, NYMEX, various publications such as Platt's, and crude oil refiners.

The intent of the proposed rule is to reduce reliance on posted prices for royalty valuation, reflect true market value, provide certainty to all involved, and provide maximum flexibility to adapt to changing market conditions.

The proposed rule was published on January 24, 1997, with a 60 day comment period. We subsequently extended the comment period by 30 days to April 28, 1997. We have also made a concerted effort to respond expeditiously to the numerous requests under the Freedom of Information Act for information related to the rulemaking. On March 14, 1997, we mailed to each of the requesters a core package of information consisting of some 415 pages. With the mailing of additional materials early this week, we have now fully responded to the requests.

**Opening Statement for Bob Armstrong for
April 9, 1997, Meeting with Senator Breaux**

Good morning and welcome.

My name is Bob Armstrong and I am from Texas. For the last four years, however, I have lived in this city and worked at the Department of the Interior. I want to know, nevertheless, that this morning's meeting is not on the issue of my sanity.

Rather, I want to express the Department's appreciation to the distinguished senior Senator from Louisiana for providing this forum on our proposed Federal oil valuation rule -- a proposed rule that has generated considerable interest.

We want to take this opportunity today to provide an overview of the proposed rule. The comment period on the rule is still open. Therefore, in accordance with the procedures required under the Administrative Procedures Act, we have a notetaker with us so that a record of this meeting can be placed in the public record of the rulemaking.

Revising our current Federal oil valuation rules began with the publication of an Advanced Notice of Proposed Rulemaking on December 20, 1995.

In 1996, we created a team of MMS, State and tribal personnel to study various market value indicators to use as possible benchmarks. We sought advice from crude oil marketers, industry representatives, the Western States Land Commissioner's organization, and other federal agencies.

The proposed rule was published on January 24, 1997, with a 60 day comment period. We subsequently extended the comment period by 30 days to April 28, 1997.

Let me remind everyone that there will be public meetings to receive comments on April 15 in Denver and April 17 in Houston.

We encourage everyone to provide their comments by the closing date. The more information we receive the better we will be able to evaluate the proposal.

We are here to educate and learn today and hope everyone will leave with a better understanding of the proposed rule. Ms. Debbie Gibbs-Tschudy, Chief, Royalty Valuation Division in Denver is with us today to provide an overview of the proposed rule.

Again, thank you, Senator Breaux, for providing this opportunity.

Industry attendees included:

Mr. David Blackmon, Burlington Resources and IPAA
Ms. Patricia Bragg, industry counsel
Mr. Ben Dillon, Director, Public Resources, IPAA
Ms. Claire Farley, President, Texaco North America Production
Mr. Jeff Fritzlen, Union Pacific Resources
Mr. Fred Hagemeyer, USX/Marathon Oil
Mr. Allen Lackey, Shell
Mr. Poe Legette, Jackson and Kelly
Mr. Jerome Meiss, Monterey Resources of Bakersfield, CA
Mr. Alby Modiano, Vice-President, Mid-Continent Oil and Gas Association
Ms. Patricia Patten, industry counsel
Mr. Greg Pensabene, Anadarko
Mr. Leighton Steward, Louisiana Land and Exploration and Mid-Continent Oil and Gas Association
Mr. James R. Senvold, Conoco, Inc.
Mr. Pat Taylor, Chairman, President, and CEO, Taylor Energy Company
Mr. Bill Whitsitt, Domestic Petroleum Council (DPC)
Mr. Roy Willis, Vice President, Independent Petroleum Association of America (IPAA)

Department of Interior attendees included:

Mr. Bob Armstrong, Assistant Secretary for Land and Minerals Management, Department of the Interior (DOI)
Ms. Cynthia Quarterman, Director, Minerals Management Service (MMS)
Lyn Herdt, Director, Office of Communications, MMS
Mr. Donald Sant, Deputy Associate Director for Royalty Management, (RMP) MMS
Ms. Deborah Gibbs-Tschudy, Chief, Royalty Valuation Division, RMP, Denver
Mr. Thomas Kitsos, Staff Assistant, Office of the Assistant Secretary for Land and Minerals Management, Department of the Interior

Sen. Breaux's staff in attendance were:

Mr. Tommy Hudson, Chief of Staff
Mr. Adam Lawrence, Legislative Assistant

Mr Sant adds:

- I know that would not be a problem, as it would not be ex parte communication.

Sen. Breaux asked:

- why not extend comment period?

Assistant Secretary Armstrong responded:

- DOI has extended it by 30 days to a total of 60 days;
- where was everyone in January?
- how much more time do you think you need?

Mr. Greg Pensabene said:

- at least 90 more days.

Mr. Fritzlen said:

- we need the rest of MMS' response to our FOIA requests before we can say how much additional time we need.

Ms. Bragg said:

- she agreed;
- she hadn't received a complete response yet;
- Greg Kann had told her he was close to providing it; and
- could MMS connect information being providing to the proposed rule?

Director Quarterman said:

- she believes MMS has provided all information it has that is responsive to companies' FOIA requests;
- if companies haven't received all of it, they should very soon;
- the bulk of the material was mailed to requestors on March 14, 1997;
- the last- and much smaller- part has been mailed and apparently is still in the process of being delivered; and
- again, MMS would like to hear from companies as to how they would improve the system.

Sen. Breaux said:

- he would like to hear from industry participants after the 2 MMS meetings in Houston and Denver on April 17 and 15;
- if he were still getting information now and having to make his comments by April 28th, he would have difficulty;
- he'd like to hear from companies as to whether additional time is needed;
- he doesn't want Congress to have to these write rules; and
- he does want MMS & industry to come up with something providing accuracy, maximizing government's return, while being fair to industry.

The meeting was concluded by Sen. Breaux at 11:45.

Director Quarterman said:

- MMS has held a number of public workshops on the RIK Pilot; and
- the last workshop is to be held in Farmington, NM in mid-May.

Sen. Breaux asked:

- if that was what industry was advocating--
- did industry want the government to sell its own oil?

Mr. Dillon said:

- no, [the government should] give it to a marketer.

Mr. Lackey said:

- MMS discovered in the RIK Pilot that it costs a lot to market crude oil so why not allow producers to deduct that cost?
- MMS allows producers to deduct transportation, why are marketing costs treated differently?

Ms. Gibbs-Tschudy answered:

- MMS believes the lease contains an implied duty to market production at no cost to the Federal lessor;
- in addition, a history of litigation has upheld our view that reimbursement for costs of putting production into marketable condition are royalty bearing;
- under the proposed rule, MMS would allow exclusion from the royalty base, of reimbursement for the following costs:
 - producers would be allowed the reasonable, actual, and necessary costs of transporting production to a point of sale remote from the lease;
 - pipeline owners would be allowed their actual costs, including depreciation, return on investment, and operating and maintenance costs; and
 - third-party shippers would be allowed the costs incurred under their arm's-length transportation agreement.
- this is the situation with the current regulations, as well.

Mr. Leggette said:

- can an MMS official [Sant] explain at the Houston meeting what part of MMS' 1988 rules are not working?

Assistant Secretary Armstrong responded:

- we should be able to explain that.

Mr. Sant said:

- I'll ask my legal advisor.

Sen. Breaux added:

- if he says "no" you will explain it at a Congressional hearing?

- only 3% of NYMEX transactions are by independent producers;
 - the independents had asked for more time to comment and for a discussion;
 - some independents' representatives attended a meeting with Director Quarterman and Assistant Secretary Armstrong several days before the proposed rule was published;
 - he felt ambushed because the rule wasn't mentioned, but it was published shortly thereafter;
 - he disagreed with what he characterized as the following MMS assumptions in the proposed rule (1) there is no market at the lease and (2) posted prices don't reflect market value.
- [handing to Sen. Breaux materials (furnished by MMS in response to companies' FOIA requests) referring to them as flip charts and slide shows]
- others have called them a "novel theory";
 - MMS has not presented underlying analysis; and
 - we need to know why and how MMS reached the two above-mentioned assumptions.

Director Quarterman stated MMS was present here today because:

- the agency wanted to address independent producers' concerns that arm's-length contracts will be disqualified by the proposed rule in too many cases;
- DOI/MMS wants/needs to have input from the audience and others on the proposed rule; and
- especially, comments are being sought by DOI/MMS on the question of where to draw the line in the proposed rule as to what constitutes an arm's-length transaction.

Mr. Dillon said:

- he wanted to address what he called an overriding issue, namely that his membership interprets MMS statements in the preamble to the proposed rule as a "threat" of a future interim final rule;
- his membership is upset because they believe MMS states, in the preamble to the proposed rule, that it wants to test its theory;
- he and Mr. Willis don't think there's a theory to test;
- we need to answer Mr. Sant's question "Is there a market at the lease?";
- that question can be answered affirmatively;
- his members are, in increasing numbers, just now beginning to think the preservation of the right to pay on arm's-length sales under the proposed rule would not be easy and that this will impact them;
- the Interstate Oil and Gas Compact Commission (IOGCC) asked for a 60 day extension of the comment period;
- there is a market at the lease;
- MMS' experts came from "financial" "paper" market perspective;
- he agreed with MMS there is not an obvious "bright line" to be drawn to separate arm's-length from non-arm's-length sales transactions; and
- independents would prefer to conduct transactions at the lease rather than look to distant financial markets to establish value.

Mr. Blackmon said

- Burlington Resources is largest independent producer in country;
- he was on the Indian gas valuation negotiated rulemaking committee;

- he had served as Co-Chairman of the Royalty Policy Committee for 2 years;
- he has been working through Independent Petroleum Association of America (IPAA) and the Domestic Petroleum Council (DPC) to develop comments on the proposed rule;
- his business has been 80% successful in changing practices to sell at the well-head, in the belief that this will reduce impact of subsequent audit, avoid certain business risks, will save administrative costs, and reduce litigation;
- the proposed rule will cause confusion by moving valuation point further from the lease;
- confusion will arise from conflicts over-- quality and gravity adjustments; transportation costs from lease to aggregation point and from aggregation point to market center; use of proper market center; proper tracking of aggregation points; and existence of a crude oil "call";
- another problem with the proposed rule is the expanded obligation to market the product;
- MMS has ability to value at the lease under the current regulations by going to comparable arm's-length sales in the field or area;
- if there are too few sales at the well-head, MMS could take product in-kind and "bid it out" to estimate value; and
- MMS is already taking 40% of its crude oil in-kind.

Sen. Breaux asked the DOI/MMS panel for any comments-

Mr. Sant said:

- mention of a possible interim final rule is not a threat nor intended to test theory; and
- rather, it was meant to give MMS flexibility to make any needed corrections more quickly and easily (in the final rule) than would be possible if the rule were to go directly to final, in which case re-proposal would be required before publication of a corrected final rule.

Mr. Dillon said:

- his members want to discuss MMS' theory before changing their business practices.

Mr. Modiano said:

- rulemaking should not be used as a process of trial and error, and
- it is better to be definite even if it takes longer.

Mr. Whitsett said:

- the DPC will be filing comments by the deadline;
- DPC members are large independent exploration and production companies; not refiners;
- DPC member companies are sophisticated in business of production and marketing;
- still, they don't understand certain aspects of MMS' proposed rule, namely its radical nature and how this complicated and untested proposal may sweep so many people into it;
- e.g., an offshore lessee sells at the platform then buys back some production to satisfy MMS' "20% set-aside" requirements;
- this would make them a "purchaser" of crude oil, and therefore unable to value their production on gross proceeds;
- DPC opposes implementing an "untested system" under either interim or final rules, as

adapting to that would cost industry hundreds of thousands of dollars, and that doesn't include costs of changing marketing practices;

- he can't understand why current rules don't allow MMS to accurately value crude oil; and
- why doesn't MMS, to eliminate uncertainty in valuation, move to a more comprehensive RIK program, marketing its crude oil itself or having a marketing company do this?

Ms. Gibbs-Tschudy said:

- to respond to industry concerns about complexity--
- the proposed rule is really not that complex;
- at the hearings on April 15 and 17, MMS would have more examples to walk attendees through;
- proposed rule would require--
 - for example, for a prompt month of October, NYMEX prices derived from taking a simple arithmetic average of closing prices for the days 8/25 to 9/25;
 - less costs of transporting from market center to aggregation point (which MMS will publish);
 - less producers' actual costs of transportation from aggregation point to the lease;
 - less appropriate quality adjustments;
- the reason MMS doubts adequacy of current (1988) rule is that majority of the crude oil from federal leases is either not sold truly non-arm's-length or it is consumed in a refinery without an arm's-length sale, so it must be valued against the benchmarks- but, MMS and the companies have had difficulty finding sufficient quantities of oil sold at arm's length within particular fields or areas to establish value using these benchmarks; and
- MMS welcomes your comments on addressing this problem.

Mr. Blackmon said:

- 80 % of his company's sales are arm's-length at the well head.

Mr. Fritzlen said:

- his company is a leading drilling company in the country;
- it's involved, as a member of IPAA, the Louisiana Mid-Continent Oil and Gas Association, the DPC, and the American Petroleum Institute, in preparation of comments on the proposed rule;
- many think this rule is unauditable and starts a new and different audit trail;
- all companies are fearful of litigation;
- it took a long time to receive responses to companies' FOIA requests;
- "flip charts" don't contain persuasive analysis;
- his company and others has asked MMS for data that back up MMS assumptions;
- their comments would be more complete if we received a response to the rest of our FOIA request; and
- they want to meet with MMS.

Mr. Hagemeyer said:

- oil is our primary product, we have production in all regions;
- we want to continue to have trust and fairness in our relationship with MMS;
- Marathon is active in selling at the lease;
- fundamental concepts of the 1988 rules are correct when they first compare to arm's-length contracts then go to net-back;
- net-backs are estimations;
- MMS "theory" needs to be tested before the rule is implemented;
- he commends MMS on its RIK Pilot, and
- he urges MMS to consider what's been learned there before further regulatory action is taken.

Mr. Svenvold said:

- thanks to MMS for the Stewardship award Conoco received;
- companies have spent time making posted prices work;
- Conoco refines 450,000 bbls daily and produces 100,000 bbls daily;
- Conoco has accepted premiums since '81;
- the company diligently tries to apply to its own transactions the same principles it applies to 3rd party transactions;
- there is massive evidence that posted prices work;
- posted prices system has always had flexibility for premiums and deductions;
- data from New Mexico lawsuit show close to 50% of sales were legitimate 3rd party transactions;
- we need to think about NYMEX;
- MMS needs to look at his testimony about fallacies raised in the New Mexico suit;
- a government agency in Calgary, Alberta considered implementing a system similar to MMS' proposed rule;
- after discussions with him, Calgary decided not to implement that system;
- we need to look at taking out, not adding, conflict; and
- he doesn't think MMS understands depth of those potential conflicts.

Ms. Patten said:

- she had not received all of MMS' response to companies' FOIA requests;
- she needed the complete response to prepare her comments on the proposed rule;
- she wants to know the underlying analysis; and
- she did not feel that litigation involving posted prices and allegations that posted prices may not indicate value provide a sufficient basis to basis for a changed regulatory scheme.

Senator Breau said:

- he wanted the Government to get everything it needs to write the final rule;
- it is not his intention that Congress write the rule; and
- it is preferable that MMS and industry come up with something acceptable to both.

Assistant Secretary Armstrong asked:

- if anyone present used NYMEX to value their production.

There was no direct response to this question at this point.

Mr. Taylor asked:

- is it true that even a "first refusal call" would place a transaction outside the arm's-length universe?

Mr. Sant answered:

- yes, that's what the [proposed] rule now says; and
- if that's not the correct place for MMS to draw the line [distinguishing arm's-length from non-arm's-length contracts] give MMS that comment.

Ms. Farley said:

- in response to Mr. Armstrong's [earlier] question about using NYMEX, we use a tendering program; and
- we want the highest price and we pay royalty on that price.

Assistant Secretary Armstrong asked:

- how much of a difference is there between NYMEX and the price you're trading at?

Ms. Farley answered:

- we are doing research on NYMEX now, and can't yet answer that.

Unidentified commenter asked:

- doesn't that mean you don't use NYMEX?

Ms. Farley

- yes.

Mr. Senvold said:

- NYMEX does not help us, the way we do business;
- real practices and processes would stay and we could function even if NYMEX disappeared;
- lease pricing wouldn't go away, though;
- NYMEX deals with next month out, and its on paper- doesn't deal with real barrels; and
- there is bad advice coming from some to MMS.

Mr. Meiss said:

- in answer to Mr. Armstrong's question, his company, operating under a special [reduced] royalty rate, found under a comparison it ran for a particular 1996 production month, that the ANS index price was \$0.52/bbl higher than what it actually received;
- purchases of oil are made to blend oil to benefit both government and state; and
- what is the status of a continuation of MMS' RIK Pilot Project?

The following comprises notes of an open forum hosted by Senator John Breaux (D., LA) on a rulemaking proposed by the Minerals Management Service (MMS) of the Department of the Interior to amend regulations governing the royalty value of crude oil. The meeting was held on April 9, 1997, in Room SC-10 of the United States Capitol. A list of attendees who made statements is Attachment 1.

Senator Breaux opened the meeting at 10:00 AM by stating that:

- he hoped to develop a discussion by industry and government about the MMS-proposed rulemaking to change the valuation of crude oil;
- there was a good cross-section of industry present, including major companies and independents as well; and
- he hoped industry could fulfill MMS' wishes and provide information to MMS to improve on the initial proposed rule from a policy perspective, rather than having a discussion between the parties' attorneys, which he believed would be less productive.

The Senator invited Mr. Bob Armstrong, Assistant Secretary for Land and Minerals Management, U.S. Department of the Interior (DOI) to speak.

Assistant Secretary Armstrong presented a statement, which is Attachment 2.

Assistant Secretary Armstrong invited Ms. Cynthia Quarterman, Director of DOI's Minerals Management Service (MMS), to speak.

Director Quarterman presented a statement, which is Attachment 3.

Director Quarterman asked Ms. Gibbs-Tschudy, Chief of MMS' Division of Valuation, to speak.

Ms. Gibbs-Tschudy provided a package of written material entitled "PROPOSED CRUDE OIL VALUATION REGULATIONS - Congressional and Industry Briefings, April 9, 1997", which is Attachment 4.

Following Ms. Gibbs-Tschudy's presentation, Senator Breaux asked Mr. Leighton Steward to moderate statements by participants.

Mr. Steward encouraged members of the audience to make their questions as concise as possible.

Ms. Farley said:

- she applauded MMS' effort to develop a simpler methodology and to lessen suspicion of valuation of crude oil;
- she felt posted prices had worked for a time but that now there are questions as to their validity;
- she was concerned about MMS' proposed rule departing from value at the physical market site of the lease; and
- the proposal creates a situation similar to "netting-back" to the lease which would be difficult to analyze and comment on in the time available.

-In response to questions from Assistant Secretary Armstrong and Director Quarterman about the amount of time she thought was needed to facilitate comments, she said that 2, 3, or 4 months might be needed, but less if a negotiated rulemaking process were used.

Mr. Taylor said:

- he was concerned that an aura of suspicion about non-arm's-length sales existed;
- he was concerned that anyone would believe that he would defraud a royalty-owner, something he wouldn't do;
- the proposed rule is too complex and would require additional paperwork;
- the "perfect price is what a person is willing to pay me with the overhead";
- his company actively markets its crude oil, seeks premiums in that marketing process, and pays royalties on premiums received;
- his concern was not about the concept of paying royalty on premiums, but rather was about the alternative valuation method in the proposed rule; and
- if the system isn't broken, don't fix it.

Mr. Sant said:

- that MMS' current oil valuation rules, promulgated in 1988, are based on the concept that royalties are due on gross proceeds, less allowable deductions;
- the problem, however, is MMS' discovery that, while companies are accepting premiums above posted prices [the sum of which constitutes their gross proceeds], many are paying royalties only on posted prices and not on the premiums;
- there is no evidence of any substantial number of sales actually taking place at the posted prices;
- the accuracy of posted prices as an indicator of value is therefore questionable; and
- the proposed rule does allow adjustments from sales prices back to the lease.

Mr. Willis said:

- IPAA had been involved in development of the gas valuation negotiated rulemaking;
 - IPAA had responded to MMS' December 1995, Advanced Notice of Proposed rulemaking;
 - MMS Director Quarterman had agreed to extend the deadline for comments on the proposed rule;
 - he understood the proposed rule to say the intention of MMS is that companies be allowed to pay on gross proceeds;
 - the more he studied the proposal's criteria for "arm's-length transaction", the less he understood it;
 - the proposed rule would disqualify a transaction from being considered arm's-length if the company has any exchanges, purchases, or "calls";
 - many independents have these arrangements with majors;
 - to disqualify independent producers' sales transactions from being considered arm's-length because of those arrangements would be devastating to them and wrong.
- [handing a document to Sen. Breaux]
- this, NYMEX' own presentation, indicates 15% of transactions it records are speculators';